

# TUCSON SUPPLEMENTAL RETIREMENT SYSTEM BOARD OF TRUSTEES

Meeting Minutes from Thursday, September 27, 2007, 8:00 a.m., City Hall

**Members Present:** Brian Bjorndahl, Chairman  
John Moore, City Manager's Appointee  
Cindy Bezaury, Human Resources Director  
Jim Cameron, Finance Director  
John O'Hare, Employee Representative  
Gage Andrews, Employee Representative

**Absent, Excused:** Paul Miner, Retiree Representative

**Staff Present:** Frank Kern, Board Counsel  
Joe Ladenburg, Deputy Finance Director  
Allan Bentkowski, Investment Manager  
Michael Hermanson, Retirement Manager  
Doris Rentschler, Finance Analyst  
Claire Beaubien, Administrative Assistant

**Guests Present:** John Behrens, Finance Analyst, Investments  
Mark Klimek, Hewitt Investment Group  
Rob Van den Brink, Hewitt Investment Group  
Carla Casem, Fund Accountant  
Jon Fenn, Friess Associates  
Gordon Kaiser, Friess Associates  
Steve Shaw, Cadence Capital  
William Bannick, Cadence Capital  
Ken Brooks, T. Rowe Price  
Ron Taylor, T. Rowe Price

## A. Call to order

Chairman Brian Bjorndahl called the meeting to order at 8:05 a.m.

## B. Consent Agenda

1. Approval of August 23<sup>rd</sup>, 2007 Board Meeting Minutes
2. Service & disability retirement ratification, and facts and figures report for September, 2007

Cindy Bezaury **moved** to approve the consent agenda as presented. John Moore **seconded** the motion. **Motion passed 6 to 0** (Paul Miner, absent excused).

## C. Applications for Medical Retirement\*

1. Gary Hibbs - following a brief introduction of this application by Doris Rentschler, Cindy Bezaury **moved** to approve the medical retirement for Gary Hibbs. John O'Hare **seconded** the motion. **Motion passed 6 to 0** (Paul Miner, absent excused).

## D. Investment Activity / Status Report

1. Manager Allocations, compared with Policy Levels; CYTD Performance by Manager, FYTD Performance by Manager  
Allan Bentkowski reported that the August 31, 2007 value of the TSRS portfolio was \$685.7m. All allocations are within their policy ranges, with total stocks at 62.6% versus their target of 64%; Bonds at 28.8% versus a 28% target and real estate 8.7% versus their target of 8%. As of yesterday, (9/26/07), the total portfolio value was just under \$696 million. Isolating the month of August, performance was mixed, with the overall fund returning .56% versus the benchmark of 1.06%; Fixed Income strategies returned 1.32% versus 1.23% for the benchmark; equities returned .25% versus .78% for the equity composite, and real estate returned .34%

versus the NCREIF of 1.51%. On a fiscal year to date basis, Fixed Income returned 2.89%, Equities returned -3.10% and Real Estate returned 2.05% versus their respective benchmarks at 2.07%, -2.37% and 3.04%. TCW Core lagged the Russell 1000 growth at .9% versus 1.59% for the month. .

Calendar year-to-date, overall fund returns were nearly equal with the benchmark at 5.46% versus the custom index at 5.47%. Bonds continue to outperform their respective benchmarks with a return of 3.20% versus 3.06%; Equities returned 5.56% versus 5.69% and Real Estate returned 10.7% versus 11.58% for their benchmark. Tracking TCW Core's performance calendar year-to-date, their returns trailed the benchmark at 6.85% versus 8.15% for the Russell 1000 growth. Fiscal year to date through August, they have returned -1.93% versus 0.2% for the benchmark.

## 2. Securities Lending Income Summary for July 2007 to June 2008

Allan reported that net client earnings for July were \$7,928 while the trustee/custodial fees were \$23,797. Allan agreed to John Moore's request to provide comparisons to prior years this information going forward.

## E. Large Cap - Growth Fund Manager Presentations

### 1. Introduction, opening comments from Hewitt Consultants

Rob Van Den Brink from Hewitt Investment Group gave a brief introduction to the Board regarding the three large cap growth fund manager candidates that are here today for Board consideration as a replacement manager for the TCW concentrated core strategy. Rob remarked that the purpose of these presentations is to provide the Board with an overview of the strategies employed by each of firm and to offer Board members the opportunity to question each candidate on their firm philosophy and experience.

### 2. Friess Associates

Gordon Kaise -client liaison and Jon Fenn, research team leader introduced themselves. Jon has 14 years experience with Friess Associates and Gordon has eight years experience with this firm, but 25 years experience in the industry. Friess Associates has been in business since 1974 and currently have \$2.7 billion in assets under management in the large cap fund arena. Gordon reported that over the past three years, Friess provided clients with an annual return of 7% over the benchmark, and over longer periods, (i.e. 5, 10 or 15 years) their average annualized excess returns exceeded the Russell 1000 Growth index by more than 5%. Friess has been able to provide strong returns during the past five years in strong (up) markets, and they have also been able to generate strong, positive returns in difficult (down) markets. Friess generate positive returns by employing consistent application of "forced displacement" by switching out of good companies to buy better ones when price target are achieved.

Jon reported that Friess Associates became employee owned in 2001 after the owner partnered with Affiliated Managers Group and employee ownership has resulted in no turnover of employees. Another motivation for generating strong performance rests in the fact that Friess' employee ownership is the largest client of the firm, having an invested in more that \$250 million in the portfolio, with the same fee structure as all of their clients.

Friess conducts a fundamental analysis and develops an information edge. Their process of sharing information is unique when it comes to moving that information around the organization efficiently by immediately sharing interview notes on an organization wide information system. Part of the reason Friess makes money is due to their ability to gather information on terrific companies before the rest of the world recognizes the strength of those companies, they move quickly whenever they see opportunities and they also tend to sell first and ask questions later when they see adverse conditions occurring on their stock holdings. They have a bottom-up fundamental style.

Jon gave an overview of the stock selection and how the stock ends up in the portfolio. He said they start with a universe of large cap stocks with rapid earnings growth potential of 20% or higher. However, they aren't willing to pay a high P/E for high growth. They look for companies with a price to earnings ratio of 25x or less. They look for those companies with a proven track record but have fallen on hard

times. Companies with experienced management and strong balance sheets are attractive. Jon said that they interview people inside and outside the company to constantly compare the information to determine which company has the best potential. Friess sells stocks for three chief reasons: 1. stocks are at the target price; 2. fundamentals have deteriorated or 3. forced displacement – forcing out good companies to buy better ones. Friess doesn't believe in keeping a stock forever. Their stock turnover ratio is very high because they don't hold on to a stock when they purchase a better stock that makes more money for the portfolio. Gordon remarked that they won't own a stock unless it exceeds Wall Street expectations. They interview customers, suppliers, and competitors to get information on a particular stock to see if that stock meets their criteria. In the last quarter, 80% of the stocks in the Friess portfolio met or exceeded Wall Street's expectations.

John Moore asked if their top ten holdings is typically nearly 42% of their portfolio, as reported in the chart dated June 30, 2007. Gordon replied that because there are typically 40-43 stocks in the portfolio, it is not atypical to have nearly half of the portfolio in the top ten. John O'Hare asked what their fees were and if they had discount fees. Gordon replied that they have a flat fee schedule with no discounts and this is applied consistently for all clients, as well as Freiss employees.

### 3. Cadence Capital

Steve Shaw, the account manager for Cadence Capitals' western U.S. clients, and Bill Bannick, Chief Investment Officer were here today for the presentation of their firm's strategy to the Board. Cadence Capital was founded in 1988, and has 22 partners that own this firm with an institutional focus. They currently manage \$8.1 billion for 91 clients. With a total of 32 employees, they pride themselves with having financial incentives that are aligned directly with their clients, so if their clients do well, the employees also benefit.

Their investment team consists of the chief executive officer, Michael Skillman, two portfolio managers, seven research analysts and three traders. Cadence feels that the tight-knit organizational structure enables them to focus resources on portfolio management. Describing their process, they first rank stocks based on growth and value characteristics using forward looking metrics such as rate of change momentum, margin improvement, earnings surprise, price momentum and earnings quality plus relative P/E and free cash flow. They look for companies that have improving fundamentals and attractive valuations. Their portfolio has approximately 75-95 stocks that they closely and continuously monitor. Cadence sells a holding if it has been a success and their relative valuations are no longer attractive, seeking a better idea than the position they are holding. Sector exposure is determined by bottom-up stock selection, with sector weightings limited to the greater of 20% or 2 times market weight.

Mark Klimek asked what percentage of company ownership is held by the top 3 partners. Bill Bannick responded that managing directors collectively own 50% of the company; however, management has plans to broaden the ownership with the other partners and employees to add opportunities for increased participation. John O'Hare asked if the Cadence staff is able to invest in the product; Steve replied that employees are able to invest via their 401(k) plan. Rob Van Den Brink asked about Cadence's overweight positions in financials, an area of the market that has struggled this year. Bill responded that they started with 20% of the Russell 1000 holdings and 8% of the broad benchmarks and most of these financial positions are broker/dealers, not financial institutions, so it isn't what it seems. John O'Hare asked Bill about turnover in their portfolio; Bill responded 100 – 125% was the norm for their portfolio.

Gage Andrews asked Bill as the chief investment officer if he makes the final decisions to buy/sell, or if decisions are made, requiring other investment team member concurrence. Bill replied that all decisions are made with a minimum of at least one of the portfolio managers and an analyst involved. Chairman Bjorndahl thanked Bill and Steve for their presentation.

Chairman Bjorndahl called for a break at 9:47 a.m. The meeting reconvened at 9:54 a.m.

#### 4. T. Rowe Price

The representatives from T. Rowe Price were Ken Brooks, Institutional Sales Executive and Ron Taylor, portfolio specialist. Ron is the portfolio specialist for the firm's large cap growth strategy with over 18 years of T. Rowe Price experience and Ken has been with the firm for three years. T. Rowe Price currently manages \$380 billion in assets, with \$64 billion under the large cap growth category. Proprietary fundamental research is their lifeblood, utilizing 122 global research analysts. This research involves contributions from industry analyst specialists across capitalization and investment styles, with a bottom-up approach that employs "stress testing" analyst recommendations to confirm conclusions. After filtering this down to the most compelling, highest conviction ideas over a 3 year time horizon, a portfolio of 45 to 60 companies are maintained in the portfolio.

Superior investment results are produced by capitalizing on two inefficiencies in the U.S. Large-Cap Growth universe. These occur when the market systematically overestimates the ability of large U.S. companies to grow at double-digit rates and when the short-term momentum and sentiment are overemphasized by investors. T. Rowe's objective is to understand and exploit these inefficiencies. Forced displacement is utilized when a stock is replaced with having better earnings potential. Ron reported that the firm's success rate in positive markets is 70% and in negative markets, 53%. Their top 10 holdings comprise 31.6% of their portfolio. Allan asked Ron about their turnover ratio which appears to be disproportionately low compared to the other managers. Ron responded that this portfolio will typically be 45-60 stocks. The general rule of thumb for their company is if you want to buy one, you have to sell one.

51% of their portfolio is found in the over \$25 billion capitalization category, while 49% of their portfolio falls between \$5 billion and \$25 billion. Those lower cap levels are considered emerging companies, like Gilead Sciences, the leading manufacturer of HIV drugs. In 1997, this company's stock sold at \$3/share. The large-cap growth strategy bought this stock in 2003 at \$17/share and it is now worth \$74/share. Allan Bentkowski asked Ron about the purchase of XM Satellite Radio. Ron responded that XM was bought prior to the merger with Sirius being announced. Rob asked Ron about their ownership of Harman International. Ron responded that Harman has enormous potential because of their numerous contracts with automakers for their "infotainment" centers. However, because of the dislocation of the credit market, a number of those deals are being pulled and they halved their position, believing that it still has excellent growth earnings potential. Gage asked Ron about their average history of company research for their portfolio. Ron responded that it was about 20 years of history for the companies that have been around that long.

#### 5. Review of manager presentations

Rob Van Den Brink took a few minutes to review the three managers that had presented their Large Cap Growth strategies. He reminded the Board that these three candidates were all totally different companies employing different strategies. In general, T. Rowe Price employs a more traditional, "blue chip" stock approach, and in that sense, they are very similar to the benchmark portfolio. Cadence is the most conservative manager of the three, utilizing growth at a reasonable price approach. Friess is relatively eclectic, given that we have a lot of index in the TSRS portfolio. John O'Hare remarked that he would eliminate T. Rowe Price because they are too close to the index and the TSRS portfolio already has managers that use a similar approach. Gage Andrews commented that he came to the meeting with a predisposition toward Cadence. However, after hearing the presentations, he now favors Friess. Their approach to researching the universe for opportunities seems truly unique. Chairman Bjorndahl concurred with Gage and John O'Hare. John Moore also concurred that Friess was his best choice. However, he voiced concern about the company's concentration of their top ten holdings being 40-50% of their portfolio. Allan pointed out that Friess has a high turnover rate so while their top ten holdings represent 40-50% of their portfolio, the same stocks won't be there a year from now, and they seemed to give the impression that they have no problem pulling the trigger when they hear bad reports about companies. Jim Cameron commented that he, too, liked Friess. He liked their philosophy, their technology, the way they gather data. He believes their fees are not a problem because their returns net of fees are still quite good. Rob commented that while they usually warn clients not to hire a manager at

the top, Friess was at the top last year, 2 years ago, 3 years ago, 4 years ago. Friess doesn't rely on one sector to produce their returns; they rotate through for the best opportunities.

6. Selection of New Growth Fund Manager

Jim Cameron **moved** to approve hiring Friess Associates as the new Large Cap Growth Fund Manager to replace TCW Concentrated Core. John O'Hare **seconded** the motion. **Motion passed 6 to 0** (Paul Miner absent, excused).

7. Termination of Existing Growth Fund Manager and Transition of Assets to New Fund Manager

John O'Hare **moved** to terminate TCW Concentrated Core as the Large-Cap Growth Fund Manager effective as soon as possible. Gage Andrews **seconded** the motion. **Motion approved 6 to 0** (Paul Miner, absent, excused).

F. Study Group Report – Post Retirement Benefits

Joe Ladenburg reported that the group has a draft document but has a few things to be ironed out before going back to the actuary for review. The general notion of the document is that funding for any kind of a cost of living adjustment (COLA) should be from excess earnings and excess investment returns based on the retirees' portion only. The actuary is working on determining what returns might have been attributable to an excess return for that purpose based on historic returns. An 80% minimum funded ratio before a transfer any excess for reserve was the group's initial proposal. However, the group's dilemma is what should be done in the future as far as the minimum funded ratio. Should the minimum funded ratio be set higher over the years? These types of considerations need to be addressed before the draft could be brought to the Board. Cindy Bezaury asked Joe if it would be possible to see a comparison between something that is funded actuarially as a given versus the cost of what the Board has been doing ad hoc. Joe replied that it would be possible. Cindy said that she would need to see that comparison before she could approve an automatic COLA.

G. Future Agenda Items

- Investment Advisory Committee revisited
- October Board Retreat – Arizona Inn

H. Call to Audience

I. Adjournment – Cindy Bezaury **moved** to adjourn the meeting. John O'Hare **seconded** the motion. **Motion passed 6-0**. Meeting adjourned 10:58 a.m.

Approved:

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Brian Bjorndahl, Chairman

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Date

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Michael Hermanson,  
Retirement Manager

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Date